SUPPLEMENT TO "INSTRUCTIONS FOR COMPLETING THE MEDICARE PRESCRIPTION DRUG PLAN BID FORM FOR CONTRACT YEAR 2006" TO ACCOUNT FOR THE PART D PAYMENT DEMONSTRATION

May 12, 2005

To support the Part D Payment Demonstration, we are providing these additional instructions for completing the bid pricing tool. The Part D Payment Demonstration allows for varied payment rules for plans offering supplemental benefits. The details for this demonstration are provided in our "Instructions for Part D Payment Demonstration" dated May 10, 2005.

The May 10th instructions describe the following three demonstration options:

1. Flexible capitation option
2. Fixed capitation option
3. MA rebate option

Generally, the capitation options replace the typical reinsurance subsidy of 80% of allowed costs after the beneficiary has $3,600 of true out-of-pocket payments (TrOOP) with a capitation amount reflecting the actuarial value of that subsidy if offered under the defined standard benefit structure. The distinction between the "flexible" and the "fixed" options is that catastrophic coverage is required to begin at $5,100 of total drug expenditures (consistent with the point at which the beneficiary would have catastrophic coverage under the defined standard benefit) for a beneficiary in the "fixed" option. The "flexible" option permits catastrophic coverage to begin at any point when the beneficiary has $3,600 of TrOOP spending.

The MA rebate option permits supplemental benefits that fill in the coverage gap to count toward the accumulation of the beneficiary's TrOOP. In this option, reinsurance will be paid based on 80% of allowed reinsurance costs after beneficiaries have satisfied their TrOOP requirement in a similar manner for non-demonstration Part D plans. As such, no change to the bidding requirements or bid pricing tool is necessary to support plans choosing this option.

It should be noted that a non-demonstration Part D plan that provides supplemental coverage will generally delay the point at which a beneficiary reaches catastrophic coverage. As such, a non-demonstration Part D plan will likely see a shift in allowed costs, from amounts that would be provided under catastrophic coverage for defined standard coverage, to amounts in the coverage gap for alternative coverage. Since the fixed capitation option and the flexible MA rebate option do not delay the point at which a beneficiary reaches catastrophic coverage, there shouldn't be a shift from catastrophic costs to gap coverage costs for these options. For the flexible capitation option, a shift in costs between catastrophic and coverage gap is to be expected.

The impact described above is illustrated in the following table of the benefit options available for Part D plans. In this table, the only benefit design change represented in the non-standard options is the changing of the point at which the coverage gap begins.

Benefit Design	Defined Standard	Enhanced Alternative	Flexible Capitation	Fixed Capitation	MA Rebate
Deductible	$250	$250	$250	$250	$250
Coinsurance	25%	25%	25%	25%	25%
Coverage Gap Begins	$2,250	$3,250	$3,250	$3,250	$3,250
Catastrophic Expense Threshold	$5,100	$5,850	$5,850	$5,100	$5,100
Catastrophic OOP Threshold	$3,600	$3,600	$3,600	$2,850	$3,600*

* OOP threshold would be met by $2,850 of actual beneficiary cost-sharing and $750 in plan supplemental benefits that would count toward the TrOOP requirement.

In completing the bid pricing tool, the alternative coverage worksheet requires costs to be allocated to below the initial coverage limit, in the coverage gap and above the catastrophic threshold. The initial coverage limit is statutorily defined to be $2,250 for 2006. For the enhanced alternative option outlined above, the actuarial value of costs for the alternative coverage between the initial coverage limit ($2,250) and the catastrophic threshold ($5,850) should be presented in the coverage gap column. The coinsurance percentage for this period should reflect that the portion of the coverage between $2,250 and $3,250 would have 25% coinsurance and the portion of coverage between $3,250 and $5,850 would have 100% coinsurance. The same would be true for the flexible capitation option summarized in the table, with both the fixed capitation option and the flexible MA rebate option would have the same pattern except that the catastrophic threshold would begin at $5,100 instead of $5,850.

<u>New Bid Pricing Tool for Capitation Options</u>

To ensure that the reinsurance capitation is appropriately reflected on the alternative coverage worksheet, the bid pricing tool applicable for the capitation option demonstrations has been modified. The new tool reflects that the reinsurance capitation amounts will be based on the development of the estimated reinsurance amounts included in the defined standard worksheet. The only change in the new bid pricing tool is that the reinsurance development in the alternative worksheet references the reinsurance development in the defined standard worksheet.

<u>Original Bid Pricing Tool Considerations for Flexible MA Rebate Option</u>

The only supplemental cost-sharing permitted in the flexible MA Rebate option is the filling in of the coverage gap. As such, no reduction in the deductible and no reduction in the cost-sharing amounts up to the initial coverage limit of $2,250 or amounts in the catastrophic period are allowed. Plan bids must reflect a $250 deductible and have cost-sharing percentages within 2% of the 25% amount (i.e., between 24.5% and 25.5%) up to the initial coverage limit and within 2% of the cost-sharing percentage estimated for the defined standard benefit structure for catastrophic coverage. See the “INSTRUCTIONS FOR COMPLETING THE MEDICARE PRESCRIPTION DRUG PLAN BID FORM FOR CONTRACT YEAR 2006” for a further discussion of this actuarial equivalence test.

<u>Modeling Considerations</u>

All plans should complete the bid pricing tool based on the population they expect to enroll. We recognize that it is difficult to estimate beneficiary characteristics and projected costs for a completely new program. We do require, however, that plans consider the effects of the benefit design being offered on the underlying population they expect to enroll. Specifically, providing supplemental coverage in exchange for a premium, or at the expense of offering other benefits, is likely to result in a change in the plan's expected risk/cost profile as compared to a plan that was offering basic benefits only. If the net value of these supplemental benefits, defined to be the difference between the actuarial value of the supplemental benefits and the amount of the premium, were to be positive for a class of beneficiaries, a plan should expect a greater proportion of these beneficiaries in their plan as compared to the class of beneficiaries with a negative value. For purposes of evaluating the effect on the anticipated enrolled population, the plan must consider the impact of the value of supplemental benefits at all points of the drug expense distribution.

The following table illustrates the pattern of supplemental benefit value for the designs summarized in the table above. Note that a supplemental premium is presented for illustrative purposes only; actual premium amounts for such coverage could differ significantly.

Benefit Design	Defined Standard	Enhanced Alternative	Flexible Capitation	Fixed Capitation	Flexible MA Rebate
Supplemental Premium	$0	$240	$220	$315	$315
Beneficiary Cost Share at Drug Expense of:					
$1,250	$500	$500	$500	$500	$500
$2,250	$750	$750	$750	$750	$750
$3,250	$1,750	$1,000	$1,000	$1,000	$1,000
$5,100	$3,600	$2,850	$2,850	$2,850	$2,850
$5,600	$3,625	$3,350	$3,350	$2,875	$2,875
$6,100	$3,650	$3,613	$3,613	$2,900	$2,900
$10,000	$3,845	$3,808	$3,808	$3,095	$3,095
Value of Supplemental Benefit:					
$1,250	NA	$0	$0	$0	$0
$2,250	NA	$0	$0	$0	$0
$3,250	NA	$750	$750	$750	$750
$5,100	NA	$750	$750	$750	$750
$5,600	NA	$275	$275	$750	$750
$6,100	NA	$38	$38	$750	$750
$10,000	NA	$38	$38	$750	$750

As with modeling other types of supplemental benefits, behavioral impacts need to be factored into the anticipated selection of the benefit. As shown in the table, beneficiaries with spending less than the $2,250 initial coverage limit will not receive any additional benefits from purchasing the supplemental coverage. We would expect that plans modeling these types of benefits consider that a lower percentage of enrollees with spending under the initial coverage limit may participate than if they were modeling a standard benefit.

Similarly, the value of the supplemental benefits decreases as the spending level exceeds the catastrophic threshold for the standard benefit in the enhanced alternative and flexible capitation option. The illustrative net value, after subtracting out the premium for the supplemental benefits, is negative for beneficiaries in excess of $6,100 of spending in the above table. Again, plans must consider the possibility of a lower likelihood of enrollment by such beneficiaries in a plan's bid development.

We recognize that the average risk profiles of members enrolled in existing MA organizations are not likely to change significantly from 2005 to 2006. This tendency towards stability may mitigate some of the behavioral effects outlined above. Plans must consider the implications of the plan designs being offered in estimating their projected population.

A final observation in the table is the difference between the supplemental premiums for the enhanced alternative and the flexible capitation options. Note that the benefit pattern for these two designs is identical, but the supplemental premium is slightly lower for the flexible capitation option. This difference reflects that the supplemental premium development for the enhanced alternative plan includes a cost component for the estimated reduction in reinsurance payments between the enhanced alternative plan and the defined standard plan (the typical TrOOP impact). Since the reinsurance capitation in the flexible capitation option is based on the defined standard estimate, there is no reduction in reinsurance value, and thus no additional supplemental premium needs to be incorporated.